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Iran: Economic Problems Ahead

While serving the Ayatollah Khomeini's short-run political purposes, Tehran's current clash with the United States could not have come at a worse time for the Iranian economy. When the US hostages were seized, the economy was basically stagnating after having partially recovered from the downswing inspired by the revolution. After a rupture of several months, Iranian relationships with foreign suppliers and contractors were just beginning to improve. 25X1 Negotiations to restart some major development projects were progressing well, and a few projects such as the Italian-contracted expansion of Bandar Abbas port had been resumed.

Now, the financial and governmental confusion generated by the US-blocking of Iranian assets and by the threats of the Iranians to default on their external debts is having an adverse effect on trade and other external relationships that will be felt for many months to come. In addition, skepticism about the government's ability and willingness to ensure personal security will slow the return of foreign contractors and technicians who are now leaving the country. Overall, spinoff from the current crisis is undermining Iran's ability to supply itself while making imports more difficult. Hence, another economic dip, as well as spot shortages of critical commodities such as food, seem in the cards over the next
25X1 several months.

While the economic downturn being brewed by the current crisis is not apt to change the Ayatollah's mind set in the short run, its political impact will be felt in the longer term. Most Iranians are willing to pay some price to ensure the success of the revolution, and for the time being many find the United States a handy scapegoat for most of Iran's problems. Nevertheless, before the current flareup in US-Iranian relations, signs of discontent with the quality of economic management were apparent, especially among some of the staunchest backers of the revolution such as the Bazaaris and urban workers. These tensions are likely to grow in the next several months as a result of commodity shortages, accelerated inflation, and persistent unemployment. 25X1

Whether or not the tensions generated by a deteriorating economic situation will crystallize into resistance against the Ayatollah's leadership will depend on several factors. Once the crisis with the United States is resolved, the Ayatollah will have to find another focus of blame for his policy blunders. He will also have to select his future policy options gingerly, taking care to avoid extremist measures, such as widespread wage and price freezes or forced return to the countryside, which could provide a focus for protest. Failure to follow 25X1 an economic course that holds the promise of a better future for most Iranians would provide opportunities for the left
25X1 and others to exploit.

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Economic activitiy, which had been progressing at a slow pace during the last year of the Shah's regime, came almost to a standstill during the most tumultuous period of the revolution. Since February, the economy has seen the recovery of the important oil sector, the partial recovery of industry, and practically no recovery in construction. Agriculture, which had been lagging before the revolution, was generally unaffected by the upheaval. [redacted] 25X1

Oil production and exports recovered fairly quickly to about three-fourths of pre-revolutionary levels. The Iranian government established a ceiling on output of around 4 million b/d, but with the continued increases in oil prices in 1979, this level provided crude exports that generated as much revenue as before. Thus, money was the least of Tehran's problems in the recovery of its economy. [redacted] 25X1

Non-oil industry picked up a little from the lows reached during the revolution then stagnated. At the start of the present crisis, industrial activity was still less than half its pre-revolutionary norms. Most Iranians have been unwilling to risk their capital and efforts in the uncertain economic climate. Many upper and middle-level managers and technicians and most of the successful pre-revolutionary entrepreneurial class have fled the country. In September, one Tehran paper estimated that 100,000 middle class citizens had left Iran in the previous six months. The businessmen who remain tend to be more interested in pulling capital out than undertaking
25X1 new investment. [redacted]

Given the uncertainties, government efforts to push money into the system -- one reason for the nationalization of the banking system -- did not yield much success. In July, the government nationalized Iranian citizen shares in the major industrial enterprises it did not already own and began to pump funds directly into the industrial sector. This effort paid off a little, and some foreign joint-venture partners of Iran began to have high hopes for an economic recovery before the embassy seizure. [redacted] 25X1

Iranian industry, of course, continues to suffer from the loss of trained Iranian managers, technicians, and entrepreneurs and of foreign workers who fled or were forced out of the country. Labor productivity -- never high to begin with -- dove further as worker councils mushroomed during and after the revolution. Workers demanded a say in the operation of the companies and the right to approve managers. In the last few months, the local revolutionary councils have been forced to place supervisors in industrial plants in order to control

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worker behavior and to report opponents to the regime. Companies have also been forced to maintain payrolls and to rehire previously fired workers. Despite these measures, unemployment is estimated at one-fifth of the labor force (around 2.2 million persons). Worker underemployment is staggering, even by Iranian standards. 25X1

The important construction sector remains moribund, although a few development projects have been resumed and some rural reconstruction work undertaken. It was this sector that provided the bulk of jobs for the unskilled rural workers who migrated to the cities during the industrial boom years, and it is from this sector that an estimated 1.0-1.2 million of the unemployed come. The general confusion of setting up a new government, the rethinking of development priorities, bureaucratic malaise, unwillingness on the part of managers to make potentially risky decisions, and reluctance on the part of foreign contractors have all contributed to the low level of construction activity. 25X1

Outward Appearances Deceiving

On the surface, life in Iran goes on much as it did before the revolution. The streets of Tehran are crowded with people and full of traffic; the stores appear generally well stocked with the smaller consumer durables. The food situation appears adequate due to seasonally high supplies of homegrown items and heavy imports of cereals and meats. The unemployment picture is noticeable only in the hundredfold increase in street vendors and the occasional protest -- prior to the seizure of the US embassy -- at the Labor Ministry. The people do not seem to be deprived, and in fact most are still receiving paychecks even if they do little productive work. The unemployed 25X1 survive through vending, occasional day labor, handouts from friends, family, and the mosque, and the small and ill-administered government unemployment compensation scheme.

Shortages Developing

Despite appearances, shortages of many commodities are in the works as Iran's ability to supply itself is declining and its ability to import becomes more difficult. Even though industry is partially operational, industrial supplies and raw materials are probably already in short supply. The stock of capital goods must also be in increasingly poor condition. Since the start of the year, aggregate exports of industrial supplies

and raw materials by Iran's six major suppliers have fallen about 75 percent compared with 1978. Capital goods exports from these countries have fallen almost as much. To some degree, the drop in purchases reflects financial confusion created by the revolution. Foreign suppliers -- even before the recent tangle in Iranian financial affairs caused by the US blocking order -- had been demanding confirmed letters of credit (L/C) from Iranian importers before shipping goods. In most instances this means the Iranian buyer must deposit 100 to 115 percent of the face value of the L/C with the issuing bank in advance -- a practice the Iranian merchant 25X1
finds difficult. In other cases, the lack of competent managers meant that supplies of needed parts and materials for government-owned enterprises have simply not been ordered.

The current financial confusion has added additional uncertainty to the trade and banking situation. the US blocking of Iranian monetary assets has led many foreign exporters to cease -- at least temporarily -- shipment to Iran. Many banks are refusing to accept Iranian L/Cs fearing lack of payment. In addition, ship operators are refusing to take on Iranian cargo due to: (a) problems with loading in the United States, (b) fear that port or labor delays will tie up their ships in Iran and that they will not be paid demurrage costs, (c) fear that the United States may take action, trapping their ships in Iran, and (d) problems with 25X1
insurance coverage. Even if these factors were reversed now, the lead time in the production and/or shipping of many of these goods (particularly machinery) could mean several months delay in receipts.

Before the embassy seizure, shortages were beginning to be reported on products such as paper goods, including packaging materials; textiles; meat; plastics; vegetable oil; soaps and detergents; medical supplies; auto parts, and motor oil. Since the embassy takeover, reports of greater shortages have been coming in, and the Iranian authorities have banned the export of all food items from Iran. Certain medical drugs are in severely short supply at hospitals and pharmacies. Eggs and poultry are scarce, and the authorities are scrambling to line up imports of cereals and feedgrains, particularly barley and rice. There are also reports of premium gasoline shortage in rural areas due to refinery problems. 25X1

Outlook

The economic situation -- already poor before the embassy takeover -- is likely to deteriorate further in the months to come. The financial and governmental confusion, as well as the lack of security generated by the current crisis, will continue to have effects for some time: (a) foreign suppliers will become more reluctant to sell to Iran, (b) foreign contractors and workers will be more reluctant to work in Iran, (c) foreign banks will push back even further any ideas of lending Iran money, and (d) more middle class Iranians will seek to leave the country. Once the hostage situation is resolved, revolutionary fervor will recede and the workers and unemployed will be reminded of their previous demands for an improvement in their lot in life. Shortages of basic commodities are likely to grow instead of decline. Civil strife may also cut into planting and harvesting next year, exacerbating the food situation. Oil will still be Iran's one hope, but here too production may fall due to labor and/or equipment problems. All in all the outlook is not good, and the Ayatollah's short-sighted policies of the present are sowing problems for him in the future. [redacted] 25X1

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The Iranian Crisis: The Global Economic Impact of a Complete Oil Export Shutdown and Some Political Ramifications

An Intelligence Assessment

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The Iranian Crisis: The Global Economic Impact of a Compete Oil Export Shutdown and Some Political Ramifications [redacted]

Summary

A complete shutdown in Iranian oil production for a lengthy period would all but eliminate any chance of significant positive economic growth in the world economy next year. The loss of 2 to 3 million barrels per day (b/d) in Iranian exports would substantially drive up world oil prices, perhaps beyond $40 per barrel. Such an oil-price hike would seriously heighten inflationary pressures and weaken non-OPEC (Organization of Petroleum Exporting Countries) balance-of-payments positions.

The developed world would be hardest hit by any oil shortfall. Under the best of circumstances, the Organization for Economic Cooperation and Development (OECD) would move into a full-fledged recession with inflation returning to peak 1974 levels. The size of the likely oil-price shock that would follow an Iranian shutdown, coupled with fears over possible output losses elsewhere, could spark a strong psychological reaction that would intensify the economic slowdown.

The non-OPEC less developed countries (LDCs) would see their hopes for further economic development seriously hurt by a full shutdown in Iran. The group's overall inflation rate would probably top 50 percent—compared to a projected 40 percent in 1979—while real economic growth at 4 percent or less would post its lowest gains in 20 years. Like many of the smaller OECD countries, numerous non-OPEC LDCs would find it increasingly difficult to finance their mounting oil bill, especially in the face of a global slowdown in world trade. In the short run, the International Monetary Fund would be able to render substantial assistance in softening the blow, but the private capital markets would be required to bear the principal brunt of additional financing needs.

The loss of Iranian oil would cause a major readjustment in the pattern of world oil trade and, in the process, increase the risk of substantially intensifying international tensions. If Tehran unilaterally cut production, however, cooperation among major industrial countries—including the imposition of joint sanctions against the Khomeini regime—could increase.

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Iran: Food Situation at Yearend [redacted]

Summary

Iran is finding it increasingly difficult to maintain the normal flow of food supplies for its population and feedgrains for the livestock and poultry industry. The country normally imports 25 to 30 percent of its food requirements; these came predominately from the United States in past years. Urban areas are especially dependent on imports for food supplies— importing up to 100 percent of their vegetable oils, 80 percent of their rice, and 50 percent of their wheat and sugar. Shortages of basic food items and long lines in shops already have been reported in Tehran and Shiraz. [redacted] 25X1

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Current food shortages are probably a result of hoarding and an inefficient and disrupted transportation system. An adequate domestic crop and a surge in grain deliveries to Persian Gulf ports in November indicate that Iranian supplies should be adequate for now. A real crunch will come early next year if foreign deliveries cannot be maintained. At that time supplies from domestic production also will be reaching a seasonal low level. The problem of maintaining food imports is not so much one of lining up alternative suppliers as it is arranging payments and deliveries. Iranian and foreign banks are having difficulty handling the confusion created by the US blockage of Iranian assets, and shipowners are reluctant to make deliveries to Iranian ports because of the risk of seizures, offloading problems, and an outbreak of hostilities. [redacted] 25X1

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